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UNCLAS SECTION 01 OF 02 CHENGDU 000294

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SUBJECT: KUNMING PHARMACEUTICAL CHIEF CLAIMS CHINESE IPR IS STRONG;  
UNFORTUNATELY FOR HIS U.S. HOLDING COMPANY, SO ARE SEC FILING  
REQUIREMENTS

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**¶1.** (U) This cable contains sensitive but unclassified information - not for distribution on the internet.

**¶2.** (SBU) Summary. Chinese intellectual property rights (IPR) have strengthened considerably in the last 10 years, the chairman of a New York AMEX-listed, Chinese pharmaceutical company claimed to Consul General in Kunming, Yunnan Province. The chairman was confident that Chinese patent law could protect his company's IP. A foreign attorney at an IPR seminar in Chengdu predicted, however, that the PRC would comply with international IPR standards (and thus also protect foreign companies) only when Chinese companies had IP worth protecting.

**¶3.** (SBU) The chairman of the Chinese pharmaceutical company complained that U.S. lawyers, auditing firms, and stock dealers were manipulating his company's stock price, and "blinding the U.S. Security and Exchange Commission (SEC)," but failed to mention that his company has been sued in a federal class action lawsuit for allegedly filing false and misleading reports with the SEC. End Summary.

No Problems with Chinese IPR,

Per Chinese Pharmaceutical Chairman

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**¶4.** (U) On November 20, Consul General and ConOff discussed evolving patent protection in China with Lan Guihua, Chairman of the Board of China Shenghuo Pharmaceutical (aka Shenghuo USA), a holding company listed on the American Stock Exchange (AMEX) in June 2007. Shenghuo USA owns Kunming Shenghuo, which engages in research, development, and marketing of pharmaceuticals and cosmetics based on Chinese herbs in the Kunming Economic Trade and Development Zone (KETDZ). According to Shenghuo Deputy Director Tan Xiangxun, the KETDZ considers his "American" firm as a high-tech foreign company, thereby qualifying it for preferential investment policies from the local government.

**¶5.** (U) According to Lan, China's IPR protection has improved considerably over the last 10 years, and his company's IP is

sufficiently protected by Chinese law. Shenghuo owns seven Chinese invention patents, and has applied for American patents and FDA approval for two pharmaceutical products. Lan said that Shenghuo's products are strongly protected by Chinese law, and would be hard for other companies to replicate. Lan claimed that, if another company violated Shenghuo patents, the infringer would face fines and perhaps corporate dissolution by Chinese authorities.

Chinese Company Lists Firm in U.S. Stock Market, But  
Finds That Cooking (Accounting) Books Is Not Allowed

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¶6. (SBU) When CG asked why Shenghuo decided to start an American holding company, Lan said that the tougher listing standards in the United States helped his company institute stronger management and financial controls over its operations. Lan also said it was "very good that there is no tradition among American companies of giving and receiving gifts." Later however, Lan opined that Shenghuo USA's stock price did not reflect the company's true value, and complained that U.S. lawyers, auditing firms, and stock dealers were manipulating his company's stock price, and "blinding the U.S. Security and Exchange Commission (SEC)."

¶7. (SBU) Conoff's research into Shenghuo's legal status in the United States revealed the basis for Lan's frustrations, and also suggest that shady PRC business practices will be under

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closer scrutiny as more Chinese companies internationalize and list overseas. Shenghuo USA, Lan, and other defendants were named in August 2008 in a federal shareholder class action lawsuit in the Southern District of New York. The plaintiffs claim that Shenghuo USA issued materially false and misleading press releases and SEC filings in 2007 and 2008, and ignored Generally Accepted Accounting (GAAP) Principles.

¶8. (SBU) In August 2008, Shenghuo USA released press statements confirming that auditors had found errors in Shenghuo's accounting practices, internal controls, and personnel management. Shenghuo's stock price dropped from \$2.58 a share in August 2008, to \$0.39 a share in December 2008. The plaintiffs claim in court filings that a former Shenghuo USA director, in his resignation letter, claimed that Shenghuo USA's internal auditing was a "sham," and wrote that Shenghuo's managers "are uneducated and seemingly unwilling to be educated on what is necessary to be a good member of AMEX or any other credible market." Shenghuo's current stock price is \$0.82 a share and the class action lawsuit is ongoing.

Will Stronger IP for Chinese Firms Eventually Help Foreigners?

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¶9. (SBU) Comment: Lan's confident attitude toward IPR suggests the emergence of a double standard for Chinese and foreign IP. Given recent reports from U.S. companies, few American firms would now be willing to trust that their IP would be protected by China's IPR regime and court system. However, the evolution of IPR in China for local companies may also eventually assist foreign companies. According to Elliot Papageorgiou, an IPR

attorney with Rouse & Co. who specializes in IPR enforcement in China, Chinese firms that have developed valuable IP are fueling the development of Chinese IPR. Papageorgiou, at a public seminar by the European Chamber of Commerce attended by ConOff in Chengdu, predicted that China would comply with international IPR standards only when Chinese companies had IP worth protecting. End Comment.

BROWN